ACQUISITION SOLUTIONS®

ACQUISITION DIRECTIONS® Advisory

ISSUES AND ANSWERS JULY 2006

Best Practices and Lessons Learned from the Front Lines

Planning, Conducting, and Managing Performance-Based Contracts for Success

By Ann Costello and Bob Welch

This Advisory *focuses on the experiences of those who have awarded performance-based acquisitions or are managing performance-based contracts.*

Whether performance based or not, procurement is harder to do well today. The scale, scope, and urgency of programs are greater than ever before. Solutions often span multiple industry sectors and multiple contractors that must form unprecedented, complex teams. It's no wonder that Government Accountability Office (GAO) reports, inspector general (IG) reports, and the trade and national press are full of "news" about real and alleged procurement problems.

When we look behind the headlines, we are struck by the fact that most of the problems are postaward contract management problems. The real challenge and frequent failure is in managing contracts once awarded. It is our view that the federal government is at least as short on experienced program and contract managers as it is short on contracting officers and contract specialists. With so few acquisition professionals, the focus is on contract award, not contract performance, and it is showing. It's no wonder that Paul Denett, nominee for the Office of Federal Procurement Policy administrator, said at his Senate confirmation hearing, "We need to strengthen contract administration to ensure we get what we are paying for in a timely manner." We believe that performance-based contracting, applied and managed well, holds the promise of improved performance and reduced costs.

Many problems attributed to performance-based acquisition are symptomatic of the difficulty in conducting and managing complex procurements *of any type.* But we think an *Advisory* that focuses on the experiences of those who have awarded performance-based acquisitions and those who are managing performance-based contracts could add to the thoughtful debate on performance-based acquisition under way in the community.

We have a pretty good idea of what is happening on the front lines. Acquisition Solutions employees have supported agency teams in more than 20 major, mission-critical performance-based acquisitions worth in excess of $16 billion. So we interviewed six of our most experienced front-line employees.

In addition, to give us a customer perspective, we assembled a "learning after" forum[1] of very experienced federal acquisition thought leaders from seven agencies who also have been front-line practitioners of performance-based acquisition and management. These experts spoke on their own behalf, with our promise of no attribution, for the betterment of our acquisition community and the profession we love. We thank them.

Now, with the belief that "knowledge that does not move has no value,"[2] we share their experiences with you.

To be successful, what do you need to know and do before contract award?

➢ **Understand that many of today's acquisitions are of unprecedented scope to the teams and agencies undertaking them**

Acquisitions today are often "grand scale," huge in scope, mission critical, largely services oriented, often developmental, and may require the support of multiple industries and contractor providers. These big buys can compel the need for unprecedented alliances on contractor teams. In addition, sometimes these contractors can be from such different industries and cultures that working together can be difficult (largely from the perspective of understanding and communication). One of our forum participants observed, "Sometimes opposites don't attract."

The road may be bumpy, and there are bound to be lessons learned. In one case, the participant said, "They had the processes and they had the people, they just couldn't execute." Sometimes the scale may be too big. If you try to do these as "business as usual," using traditional procedures, processes, and people, you will have started to fail before you start.

➢ **Plan for postaward contract management at the start**

Federal Acquisition Regulation (FAR) 7.105 provides that written acquisition plans must address contract administration, but mission-critical performance-based buys require much more comprehensive planning. We have described an approach to performance-based management that sets forth six disciplines: cultural transformation, strategic linkage, governance, communication, risk management, and performance monitoring.[3] Planning for—and beginning to execute—these disciplines begins early in the acquisition life cycle.

For example, for some agencies, just doing a performance-based acquisition requires cultural transformation. Our employees commented on this. It takes training and readiness on many levels: an understanding of performance-based techniques, a ready attitude, a well-prepared team (with structure, policies, and a communications plan), and the management skills to oversee performance-based contract work. Other success factors are (1) evaluating the competing contractors' proposed approaches to contract performance management and measurement, and (2) keeping the critical members of the government team on the project after award.

Strategies for governance, risk management, and performance monitoring are especially important during preaward and postaward. An employee observed that, in one case, "the postaward phase was not formalized," which was especially problematic when there was a "changing of the guard" to different people to manage the contract after award.

One of our associates commented, "At [my former agency] I had all major acquisitions develop a formal contract management plan (per an internal guide on how to develop one) *before* or *contemporaneously* with award of the contract. The 'best practice' was to engage the [Source Selection Evaluation Board] in the development effort because of their insight into contract requirements and the contractor's proposal. Obviously, this was to ensure that all the contract admin functions, most particularly those performed outside the immediate contract organization, were actually understood and performed and integrated by the right people consistent with the contract expectations and to enable the government to hit the ground running."

During the preaward phase, one participant planned for and later conducted regular meetings of a high-level "Governance Board." The purpose of the board was to review issues related to the performance of the task and to help resolve those that were not addressed at lower levels.

If you do not begin postaward planning well before the contract is awarded, you will have dramatically increased the likelihood of failure.

➢ **Take time with market research, especially if the acquisition will lead to transformational change**

One participant credited his agency's *year* of market research as important to transformational change management. (As to the year, his agency also had taken the position that "if *anyone* asked, we had to talk to them.") In response, another participant said her agency had "set rules for market research." Another said, "It really opened my eyes. We'd always done it 'that way' . . . and 'that way' was not the best."

Often agencies believe they already have done their homework. One of our employees observed that an agency he worked with had at first considered more market research to be wasted time, but it ultimately helped inform the development of the statement of objectives and "it paid off in the end." The result was a highly successful performance-based acquisition that won kudos from the program office. In another case, our team convinced an agency to test the market one more time. The agency released a request for information, found more companies, and brought them in to learn more. As one employee said, "You are learning what industry knows."

➢ **Take time to analyze and understand the real requirement and real objectives as well as possible**

The more complex the acquisition, the harder this is. One participant said, "We didn't know at the beginning whether we had a project management requirement, an information technology requirement, or an engineering requirement." As it turned out, the requirement was all those things and more. Another observed that this is really hard work and may at times require a champion with highly developed facilitation skills. He observed, "People who can't define requirements also can't define objectives."

➢ **Understand that due diligence is essential to performance-based acquisition, but you may get push back . . . so push back, too**

Start with the simple fact that the more potential offerors know about your requirement, the better their proposals will be. One forum participant said "the lawyers choke on due diligence . . . and the potential for release of proprietary information . . . but if you can't do due diligence, you're in trouble." Many techniques have been used to help the vendors learn: data dumps on CDs, in libraries, and on websites; background information briefings; facility tours; industry days; and question-and-answer meetings directly with government staff.

Our employees agree with the effectiveness of the approach. "Due diligence worked extremely well in all instances." And, one noted, "Vendors gave high praise for

What is "due diligence"?

The term "due diligence" is used in acquisitions to describe the period and process during which an agency affords competitors the time and opportunity to become knowledgeable about its needs in order to propose a competitive solution. Due diligence usually includes site visits, meetings with key agency people, and research and analysis necessary to develop a competitive solution tailored to agency requirements. Due diligence is afforded to competitors separately. In other words, contractor teams have access to agency personnel without their competitors present.

Does the FAR support the use of due diligence?

Yes. The Federal Acquisition Regulation (FAR) permits exchanges of information between the government and contractors—and even requires the government to protect that information. Even when the rule-laden FAR Part 15 competitive procedures are used, due diligence is conducted before receipt of proposals, making communications with potential offerors "exchanges with industry before receipt of proposals" (FAR 15.201). That section provides (in pertinent part):

> Exchanges of information among all interested parties, from the earliest identification of a requirement through receipt of proposals, are encouraged. Any exchange of information must be consistent with procurement integrity requirements (see 3.104). Interested parties include potential offerors, end users, Government acquisition and supporting personnel, and others involved in the conduct or outcome of the acquisition.
>
> The purpose of exchanging information is to improve the understanding of Government requirements and industry capabilities, thereby allowing potential offerors to judge whether or how they can satisfy the Government's requirements, and enhancing the Government's ability to obtain quality supplies and services, including construction, at reasonable prices, and increase efficiency in proposal preparation, proposal evaluation, negotiation, and contract award.
>
> *Information provided to a particular offeror in response to that offeror's request shall not be disclosed if doing so would reveal the potential offeror's confidential business strategy*, and would be protected under 3.104 or Subpart 24.2. [Emphasis added.]

Note that if other acquisition approaches are used, such as use of Federal Supply Schedule contracts (FAR Subpart 8.4) or use of multiple award, indefinite-delivery, indefinite-quantity contracts (such as GWACs and multiagency contracts) (FAR Subpart 16.5), there are even fewer provisions that address or limit communications with industry. Even so, the provisions in FAR 15.201 make sense and can guide agency actions when using other than negotiated procurement techniques.

So the FAR supports answering contractor questions "one on one" during due diligence?

Yes, the FAR completely supports this process. While fundamental information should be collected and made available to all the prospective offerors, there is no prohibition against contractors asking questions and an agency representative or team responding during a private meeting. In fact, FAR 15.201(c) promotes the use of one-on-one meetings as a means of early exchanges of information with potential offerors.

To learn more, go to the source:
Acquisition Directions® *Advisory*,
"Cutting-Edge Acquisition: Due Diligence"
http://www.acqsolinc.com/km/ADpubs/pubs/adv03-04.pdf

the process and the openness provided by the agencies." It leads to better solutions and better proposals.

Our recommendation is simple. If agency officials prohibit or object to this critical phase of the procurement process, please show them the discussion on page 3 (or the *Advisory* referenced in the footnote). Trying to conduct a performance-based acquisition without due diligence will not produce top-quality proposals.

➢ **Understand that size can matter**

"If the prime is small, the prime can't push around a large sub," observed one of our participants. Recall our initial point about the complexity of teaming arrangements? This is a real issue that is little understood by many government buyers. How much can a $10 million company direct a subcontractor that is 100 times bigger, particularly when there are performance issues? If the agency wants a small business prime, the government should consider a strategy that extends to *team* contract performance management, not just *prime contractor* performance management—and incorporate performance metrics and incentives that encourage the team performance you want.

➢ **Don't overlook "mandatory requirements" (i.e., constraints) when using a statement of objectives**

At least half of those who attended our thought leader forum had performance problems emerge on systems development efforts. The contractors thought they understood the government's needs, but didn't. The government thought they knew what would be delivered, but didn't. This reinforces the importance of both well-conducted due diligence and careful evaluation of the contractor's proposed solution.

One agency that had a "profound success" and cultural change as well used a statement of objectives that included in its "technical and management considerations . . . specific information that applies to servicing activities, loan accounting, default management, information technology (IT) exchange and accessibility of information, customer service, and other related information that applies to how [the agency] does business." We note that with system development efforts, you must establish performance standards and metrics for various phases: development, implementation, and steady state.

➢ **Release budget information to enable contractors to correctly size the solution**

You don't want the "supersize" solution when you have a "kid's meal" budget. In one case, the agency team was not allowed by their legal office to release budgetary information, so they were bid solutions they couldn't afford. All this does is waste time and money. Yet this approach is routinely taken by many agency contracting offices.

FAR 15.306(e)(3) allows agencies to provide offerors with budget information. While the specific paragraph is titled "Exchanges with offerors after receipt of proposals," it includes this language: "*It is also permissible, at the Government's discretion, to indicate to all offerors the cost or price that the Government's price analysis, market research, and other reviews have identified as reasonable* . . ."

Having this information allows all offerors to adjust their mix of resources and helps them in sizing their solutions and avoiding proposals that are not affordable.

Related to the size of the budget is the "color" of the money and the limitations it may impose on solutions. In one case discussed in our forum, an agency received a very innovative solution at a much lower cost than had previously been expended. However, the solution rearranged costs in a way that didn't fit the preapproved agency funding strategy.

The participant indicated that the type of funds (research and development, operations and maintenance, or other specific-use funds identified in the agency's budget) must be made part of the acquisition strategy and set aside in advance. If the type of funds available were to change for any reason (funds were needed elsewhere for new, higher priority requirements; the mission changed; or the government altered the conditions on which the original solution depended), then the government might have to "undo the performance-based solution." The fallback position in at least one case was a more traditional requirements-based effort that could be supported by the available funds and what the agency was willing to spend.

[Note: We have answered client inquiries about releasing budget information numerous times. To see a sample response, go to http://acquisition.gov/comp/seven_steps/library/ADannounce-funding.pdf.]

To be successful, what do you need to know and do during competitive pool formation, evaluation, selection, and award?

➢ **Be aggressive in researching potential sources**

When evaluating past performance as an indicator of future success, use sources other than those provided by offerors. In one situation, agency personnel who were listed as past performance references had been barred by a termination settlement agreement from "telling the truth" about a contractor's performance on a certain contract.

➢ **If you're going to buy a service, make sure the contractor has it already**

"If the contractor has to build a system to deliver a service, you're not buying a service," said one participant.

➢ **Be cautious and inquisitive if there is a wide variance in cost, implementation schedule, or solution scope**

Seek to understand the reasons underlying the difference: Has the contractor made an investment in intellectual property that enables it to perform faster with a proven methodology? How much of the commercial-off-the-shelf software is commercial, and how much has to be tailored? How much of the government's time will the tailoring take? What is the logistics tail, and what are the life cycle costs?

➢ **Take all necessary steps to make sure there is clarity in what is being bought under the contract in terms of performance, cost, and schedule**

One participant said, "Once contract performance was under way, we weren't sure what we agreed to." That required a lot of discussions. Another said, "The contractor submitted a work breakdown structure that didn't address refinement of the requirements."

One of our employees observed that "a critical part of a performance-based evaluation is the quality of the contractor's work breakdown structure and what it conveys about performance risk. Is it comprehensive, and does it identify a thoughtful plan to seek results? Does it reflect an understanding of the agency's objectives?" Are you buying the work activities—*generally not, we think, under a performance-based contract*—or are you buying the results of those activities, in the terms of performance metrics, specified results or outcomes, or service-level agreements? The latter has been our view. Payment should be tied to results, not moving through a list of planned activities. Our employee said, "If the contract is structured for payment based on results, and not for activities, then the contractor is on the hook to achieve the results. The risk of performance is the contractor's."

In another example we are aware of, the contractor had inserted a caveat that the proposed performance metrics were examples only and that actual metrics would be negotiated postaward. The evaluation team missed this exception. Once the contract was awarded, the agency was unable to establish performance metrics like those proposed examples. Metrics must be established before contract award, preferably in the heat of competition.

➢ **Make sure the contractor's incentives are aligned with what's best for the agency and the program**

In a "profound success" example discussed at the forum, the incentive structure and terms of the contract had enabled the ["really good"] contractor to invest to improve its performance for the agency.

➢ **Understand that you can receive very innovative solutions at cost-cutting prices and still have a problem**

Regarding the "color of money" issue, an agency evaluated and selected one offer as high technical, low cost, but despite major efforts to find a way to take advantage of the solution, the agency team was unable to "rewicker the funding stream" to match the solution. One way to avoid this situation is to release funding information to contractors so that you receive executable proposals.

➢ **Consider the life cycle implications of the solution**

Some solutions have a long cost or logistics tail in their implementation. "We made companies responsible for design and development without considering maintenance," said one participant. As a result, every vehicle has multiple pumps, of various configurations and manufacturers, creating a logistics nightmare. "You must consider configuration standardization and control, maintainability, and logistics."

➢ **Turn over life cycle maintenance to a contractor**

Instead of the government maintaining warehouses with tires, we contracted out that service, said one participant. Establish what to support and what the delivery time frames are and leave the responsibility to the contractor. His experience was that (even with Iraq) the contractor maintained operational availability and reliability, and long-term cost reductions are expected.

To be successful, what do you need to know and do after contract award?

➢ **Start right, provide resources, and manage through it**

Begin active contract management with the kick-off meeting. Use that meeting to reiterate the governance model, communications strategy, risk management process, and performance monitoring approach. From the moment of contract award, ask, "How are *we* going to be successful?

Monitor contractor performance beginning the day of contract award. If it emerges that there's not a shared understanding of performance, fix it immediately. In the cases discussed at our forum where performance problems emerged, agency teams recognized the problem within the first few months and began to take action to correct it. One participant said his team had used monitoring tools and had found out faster than they would have otherwise that "the ship was about to hit the shoals."

In another case, the agency just did not make the investment in contract performance management. One of our employees said, "The government only had *one* person for a billion-dollar effort. The agency never staffed up to manage the work."

➢ Make sure a knowledgeable and engaged governance board and process are in place

Building on the best practices above, forum participants recommended establishing a Project Management Office and using processes and tools such as project performance managers, project reviews, earned value management, and a strong independent validation and verification capability. One participant said, "We found the bleeding early and stopped it." Another said, "We saw it early on and hit hard." Another said, "We make it a practice to escalate quickly."

➢ If the way to "fix it" is not clear, find a way

One participant likened the process to "marriage counseling." Contract performance problems discussed at our forum developed from many causes, most not contemplated in advance. One participant cited "underestimated complexity" as a cause and had to invest resources to continue to shepherd the contractor team to better performance. The same team found that not all stakeholders—in fact, not all individual stakeholders in a stakeholder group—shared the same objectives. This led to a need for a long-term change management process on a national level, made more difficult because the agency does not have the authority to mandate action. Another team discovered that working through performance problems on task orders or blanket purchase agreements under GSA's schedule program was difficult because a third party is introduced—the GSA contracting official who administers the multiple award contract.

➢ Rebaseline if necessary to achieve performance

A number of participants indicated they needed to rebaseline the performance expectations when there was not shared understanding or contract clarity and/or when time or costs or both began to deviate from expectations. Two agency teams independently came to the solution of using a "statement of priorities" or of assessing and communicating to the contractor "what's critical," and reprioritizing as necessary. One negotiated a cost-sharing arrangement with the contractor, creating a true partnership in the turnaround. "We were months late, millions over, but we delivered. We didn't play the blame game. We had people in the field depending on us."

➢ Phase if necessary to achieve performance

One agency scaled back and employed phases to manage a turnaround in contract performance. Entrance and exit criteria were established for each phase—and funding was tied to each phase's successful completion.

➢ Be prepared to be tough and fair

In one case, a contractor missed a major deliverable and, therefore, the agency did not award the anticipated award fee. The contractor's stock price dropped and the subsequent management attention on the contractor's part helped move performance to improved levels quickly. In other cases, "cure notices" were issued, with varying degrees of success.

➢ Establish an Award Fee Board and stick to the performance review schedule

A powerful method of managing performance is use of an Award Fee Board with a *regularly adhered to* performance review schedule. But remember to conduct training and include the entire team. One participant advised that training all participants in the award fee process at the same time would have made the board more effective.

➢ Be prepared to take on an unexpected role

One participant found that his team had to become responsible for requirements management in the system development process. The agency is now using a "requirements management tool" to manage 1,000 requirements being implemented using a commercial off-the-shelf system as a base. Another had to hire "systems knowledgeable" staff to manage contractor performance.

➢ Expect and look for corollary benefits

In one very complex acquisition involving a less than successful business process reengineering and system development effort, the very process of market research, due diligence, and competition led, across the agency's existing incumbent contractor base, to performance aspects that were "dramatically cheaper, dramatically better" and a "better operational deal" on ongoing program maintenance.

➢ Learn and adapt throughout the process

One forum participant said, "You can't think it all through at first." Every contract performance experience brings learning. Even with significant time devoted to market research, you always will know more later than you know now. One participant said, "We asked ourselves, how did we *not* know that?" Another said, "We truly didn't know what we needed when we started." The simple answer is that, not only do you not know all there is to know before award, you probably do not even know all the questions you need to ask. And chances are what you know "for sure" may change, too. Expect it.

➢ Try a contract transformation

If you come to realize that the contractual agreement is just wrong, you do have an option. A contract trans-

A huge advantage of using a performance-based approach and management techniques is that you have a better framework for meeting the challenges and solving the problems.

formation—rebaselining on a grand scale—is a facilitated means to bring an agency-contractor team to agreement on a common set of expectations based on the goals and objectives of the agency. This approach allows the agency and the contractor to refocus a project on its key mission success factors and to align those factors with the goals of the overall program. The results can be astonishing. At one agency that Acquisition Solutions supported through ten transformations, the return on investment was astounding. That agency saved millions of current fiscal year dollars.[4]

Contract transformations put the "we" back in the agency-contractor relationship. As one of our employees observed, "If the contractor fails, the agency team fails." Successful performance-based contracts are a team effort. "Align the personal incentives, contractor, and government personnel, and watch what happens!"

➢ **If all else fails, terminate the contract or sever the business relationship by other means**

Sometimes a bad contract doesn't get better. But remember the marriage analogy: Nobody wins in a divorce, and certainly not the mission that the acquisition system is supposed to be supporting.

➢ **Understand that there is no "silver bullet," and no such thing as a perfect contract**

The situation begins to change as soon as the ink is dry. Sometimes the government is the cause, sometimes the contractor, but more often than not the cause is shared. In one case discussed at our forum, a solution was dependent on the use of shared facilities that had been established (preaward) as acceptable. Post-award the agency position changed, dramatically affecting one critical condition on which the contractor had based the solution and pricing. As a result, the performance-based solution began to "unpeel."

➢ **Be a champion for your agency, your program, and your contract**

All of our participants have worked tirelessly for the interests of their agencies and have taken many steps, some quite inventive, to realize improved performance and accomplishment of their agencies' missions.

Conclusion

We noted in the beginning of this *Advisory* that many problems attributed to performance-based acquisition are symptomatic of the difficulty in conducting and managing complex procurements *of any type.* In reality, the only constant is change. Expect it and build the flexibility to change into the contract.

A huge advantage of using a performance-based approach and management techniques is that you have a better framework for meeting the challenges and solving the problems. Manage through it. Expecting flawless execution sets up failure. ♦

Endnotes

1 The concept of learning before, during, and after work experiences is part of the knowledge management framework used at Acquisition Solutions. To learn more about these processes, refer to the Acquisition Directions® *Special Report*, "Knowledge Capture, Transfer, and Reuse: Ensuring Relevant and Critical Knowledge of the Federal Acquisition Workforce Is Retained and Leveraged," viewable to subscribers at http://www.acqsolinc.com/km/ADpubs/pubs/rpt06-05.pdf.

2 Bill Kaplan, chief knowledge officer, Acquisition Solutions, Inc.

3 Acquisition Directions® *Advisory*, "Performance-Based Acquisition Requires the Six Disciplines of Performance-Based Management," May 2004, viewable to subscribers at http://www.acqsolinc.com/km/ADpubs/pubs/adv04-04.pdf.

4 Acquisition Directions® *Advisory*, "Contract Transformations: A Tool for Program Managers," August 2002, viewable to subscribers at http://www.acqsolinc.com/km/ADpubs/pubs/adv02-08.pdf.

The *Advisory* is published monthly as part of the Acquisition Directions® subscription service, made available by Acquisition Solutions, Inc., 1655 North Fort Myer Drive, Suite 1000, Arlington, Virginia 22209, 703-253-6300, fax 703-253-6301, www. acquisitionsolutions.com. Information and opinions are based on best available information, but their accuracy and completeness cannot be guaranteed. Layout by Julie Olver.